

## Internal Revenue Service

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:

ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-123317-16

Date:

November 01, 2016

## LEGEND

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

LLC =

Trust1 =

Trust2 =

a =

b =

c =

Dear :

This responds to a letter dated July 21, 2016, and subsequent correspondence, submitted on behalf of X by X's authorized representative, requesting relief under § 1362(f) of the Internal Revenue Code (the Code).

#### FACTS

According to the information submitted, X was incorporated under the laws of State on Date 1. X elected to be treated as an S corporation effective Date 1. On Date 2, a shares of stock in X were sold to LLC, a partnership for federal tax purposes. The partners of LLC were Trust 1 and Trust 2, both trusts. LLC, as a partnership, was an ineligible shareholder of an S corporation. On Date 3, X's accountant learned that the transfer of stock to LLC terminated X's S election. On Date 4, LLC distributed all of its a shares of X stock to Trust 1 and Trust 2 in accordance with their relative interests in LLC, b shares to Trust 1 and c shares to Trust 2. Effective on Date 4, Trust 1 made an election to be a qualified subchapter S trust ("QSST") within the meaning of § 1361(d)(3) and Trust 2 made an election to be an Electing Small Business Trust ("ESBT") within the meaning of § 1361(e)(1).

X represents that Trust 1 has at all times since Date 2 satisfied the requirements of a QSST, except that until Date 4 Trust 1 did not own the stock of X and the beneficiary of Trust 1 did not make a QSST election. X represents that Trust 2 has at all times since Date 2 satisfied the requirements of an ESBT, except that until Date 4 Trust 2 did not own the stock of X and the trustees of Trust did not make an ESBT election.

X represents that, from Date 2 onward, it filed its tax returns as if it were an S corporation. X represents that the amount of tax paid during this period was the same as if Trust1 held b shares in X stock directly as a QSST and Trust2 held c shares in X stock directly as an ESBT.

X represents that it did not intend for its S corporation election to terminate and that the events that resulted in the termination were not motivated by tax avoidance or retroactive tax planning. Further, X and its shareholders agree to make any adjustments required by the Secretary consistent with the treatment of X as an S corporation.

## LAW AND ANALYSIS

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that a trust, all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States, may be an S corporation shareholder.

Section 1361(d)(1) provides that a QSST whose beneficiary makes an election under § 1361(d)(2) will be treated as a trust described in § 1361(c)(2)(A)(i), and the QSST's beneficiary will be treated as the owner (for purposes of § 678(a)) of that portion of the QSST's S corporation stock to which the election under § 1362(d)(2) applies.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) defines a QSST as a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only one income beneficiary of the trust; (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary; (iii) the income interest of the current beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust; and (iv) upon the termination of the trust during the life of the

current income beneficiary, the trust shall distribute all of its assets to that beneficiary; and (B) all of the income (with the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to one individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(iii) of the Income Tax Regulations provides that if S corporation stock is transferred to a trust, the QSST election must be made within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an ESBT may be an S corporation shareholder.

Section 1361(e)(1)(A) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that an ESBT does not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides, in relevant part, that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii). Generally, only one ESBT election is made for the trust, regardless of the number of S corporations whose stock is held by the ESBT. However, if the ESBT holds stock in multiple S corporations that file in different service centers, the ESBT election must be filed with all the relevant service centers where the corporations file their income tax returns. This requirement applies only at the time of the initial ESBT election; if the ESBT later acquires stock in an S corporation which files in a different service center, a new ESBT election is not required.

Section 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a

QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever the corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in termination, steps were taken so that the corporation is once more a small business corporation, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period, then, notwithstanding the circumstances resulting in the termination, the corporation will be treated as continuing to be an S corporation during the period specified by the Secretary.

## CONCLUSION

Based solely on the information submitted and the representations made, we conclude that X's S election terminated on Date 2 when the X stock was sold to LLC. We further conclude that the termination was inadvertent within the meaning of § 1362(f).

Accordingly, under § 1362(f), X will be treated as continuing to be an S corporation on and after Date 2, provided that X's S corporation election was valid and not otherwise terminated under § 1362(d). However, this ruling is contingent upon the beneficiary of Trust 1 filing a QSST election with an effective date of Date 2, and the trustees of Trust 2 filing an ESBT election with an effective date of Date 2. The QSST and ESBT elections must be filed with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the QSST and ESBT elections.

If the QSST and ESBT elections are made as instructed herein, Trust 1 shall be treated as owning b shares of the stock of X from Date 2 and Trust 2 shall be treated as owning c shares of the stock of X from Date 2. Accordingly, the shareholders of X, including Trust 1 and Trust 2, must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make an adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to make these elections or treat X as described above, this letter ruling will be null and void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X is otherwise eligible to be treated as an S corporation, whether Trust 1 is eligible to be a QSST, or whether Trust 2 is eligible to be an ESBT.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

Sincerely,

*Faith P. Colson*

Faith P. Colson  
Senior Counsel, Branch 1  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter  
Copy of this letter for § 6110 purposes

cc: